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No. 02-714

In the Supreme Court of the United States

THE STATE OF OKLAHOMA, EX REL.,
OFFICE OF STATE FINANCE, PETITIONER

v.

TOMMY G. THOMPSON, SECRETARY OF HEALTH AND HUMAN SERVICES, EX REL., DEPARTMENT OF HEALTH AND HUMAN SERVICES, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether Office of Management and Budget Circular No. A-87, which establishes the standards for determining the costs of federal awards carried out through grants and other agreements with state and local governments, impermissibly interferes with the State of Oklahoma's management of its fiscal affairs.

2. Whether a State may use federal funds, which are provided as reimbursement for the cost of health benefits for state employees who work on federally funded programs and which are intended for deposit in the state's self-insurance reserve fund, for nonfederal purposes.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 2-8) is reported at 292 F.3d 1261. The order of the district court is unreported.[1] The final decision of the Department of Health and Human Services Departmental Appeals Board (Pet. App. 17-33) is *available in* 1998 WL 673808.

[1] Petitioner's appendix contains a preliminary district court ruling on issues not raised by the petition (Pet. App. 11-16), but does not contain the district court's final order and judgment. For the Court's convenience, they are included at Appendix, *infra*, 1a-7a.

JURISDICTION

The judgment of the court of appeals (Pet. App. 1) was entered on June 12, 2002. A petition for rehearing was denied on August 12, 2002 (Pet. App. 9-10). The petition for a writ of certiorari was filed on November 12, 2002 (following a holiday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Numerous federal benefit and grant programs are implemented jointly by the federal government and the States. The statutes that create those programs and appropriate funding for them also authorize the use of federal funds to reimburse the States for certain costs they incur in administering the programs. See, *e.g.*, 42 U.S.C. 1396b(a)(7) (reimbursement of amounts "necessary * * * for the proper and efficient administration of the State [Medicaid] plan"). In addition, general federal appropriations law mandates that "[a]ppropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law." 31 U.S.C. 1301(a).

In Circular No. A-87, "Cost Principles for State, Local, and Indian Tribal Governments," the Office of Management and Budget (OMB) has established uniform standards for determining the allowable costs of administering federal programs. 60 Fed. Reg. 26,484, 26,489 (1995). A fundamental premise of Circular No. A-87 is that governmental units, such as States, "are responsible for the efficient and effective administration of Federal awards through the application of sound management practices." *Id.* at 26,490. States are also expected to "administer[] Federal funds in a manner consistent with underlying agreements, pro-

gram objectives, and the terms and conditions of the Federal award." *Ibid.*

To be "allowable," costs must meet certain general criteria. For example, costs must be "necessary and reasonable" and "allocable to Federal awards." 60 Fed. Reg. at 26,491. "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received." *Id.* at 26,492. Among the specific costs that are allowable is compensation for personnel services, including salaries and fringe benefits, provided that such costs satisfy the general criteria of Circular No. A-87. *Id.* at 26,494. "Fringe benefits" explicitly include "*employer* contributions" for employee health insurance. *Ibid.* (emphasis added). Excluded from the definition of costs, however, are "transfers to a general or similar fund." *Id.* at 26,491.

OMB has delegated to the Department of Health and Human Services (HHS) responsibility for reviewing Statewide Central Service Cost Allocation Plans. 60 Fed. Reg. at 26,501. Those plans include "all central service costs that will be claimed (either as a billed or an allocated cost) under Federal awards" and must contain certain information. *Ibid.* For example, Circular No. A-87 sets forth specific requirements pertaining to state "self- insurance" funds, through which States provide health and other benefits to their employees and insure state property. With respect to a self-insurance plan, a State's cost allocation plan must include, *inter alia*, the self-insurance fund balance sheet; a statement of revenue and expenses; a list of all non-operating transfers into and out of the fund; an explanation of how fund contributions are determined; and a description of the procedures used to charge fund contributions to benefitted activities. *Id.* at 26,502.

The state plan also must provide detailed information concerning the self-insurance fund's reserve level. Contributions to reserves must be based on "sound actuarial principles," and "[r]eserve levels must be analyzed and updated at least biennially for each major risk being insured." 60 Fed. Reg. at 26,499. Reserve levels in excess of amounts correlating to claims "must be identified and justified in the cost allocation plan." *Ibid.* Moreover, if funds are transferred from a self-insurance reserve fund to a general or other fund, the federal government must be reimbursed for its share of the transferred funds, plus interest. *Ibid.*

HHS's Division of Cost Allocation (DCA) reviews state plans to ensure that the federal government is bearing its proper share of the costs of administering joint federal-state programs. As a result of such reviews, DCA may "disallow" a claim for federal funding, and a State may request reconsideration. See, *e.g.*, 42 U.S.C. 1316(d). HHS's Departmental Appeals Board renders the final decision in such appeals, based on the State's and DCA's written submissions and/or the record developed at a hearing. See generally *Board of Trs. of the Pub. Employees' Ret. Fund* v. *Sullivan*, 936 F.2d 988 (7th Cir. 1991), cert. denied, 502 U.S. 1072 (1992).

2. As part of their compensation, employees of petitioner, the State of Oklahoma, are given a "flexible benefit allowance," an amount credited by their employing State agencies for the purchase of health insurance and other benefits. Oklahoma State Employees Benefits Act, Okla. Stat. tit. 74, §§ 1363.12, 1370.B (Supp. 2002). Employees must use that credit to purchase a health insurance plan, but they have the option of choosing insurance from either a private insurer or the State's own self-insurance plan. *Id.*

§ 1371. Petitioner's health insurance plan was established by the State and Education Employees Group Insurance Act (Group Insurance Act), Okla. Stat. tit. 74, §§ 1301 *et seq.*, and is administered by the Oklahoma State and Education Employees Group Insurance Board (OSEEGIB). In addition to state employees, employees of local governments, school districts, and other groups may also participate in petitioner's self-insurance plan. Pet. App. 4.

Ordinarily, "all employee and employer contributions" to the OSEEGIB health insurance plan are deposited directly into the State Treasury's Health and Dental Insurance Reserve Fund (Reserve Fund). Okla. Stat. tit. 74, § 1312(1) (1995).[2] The money in the Reserve Fund is used to pay claims and administrative expenses and to generate investment income. *Ibid.* In a 1996 amendment to the Group Insurance Act, however, the Oklahoma legislature directed "each state agency" participating in the State's self-insurance plans to "appropriate and pay to the State Employees Group Insurance Clearing Fund" (Clearing Fund), during fiscal year 1997, "an amount to be set by the [OSEEGIB] for each employee * * * enrolled in said Plans, from funds appropriated to said agency or *from other funds available to such agency for operational purposes.*" *Id.* § 1310.B (Supp. 2002) (emphasis added). The first $31.5 million paid to the Clearing Fund was to "be distributed to the Oklahoma State Regents for Higher Education," with any balance distributed as directed by the OSEEGIB. *Id.* § 1312.3.

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[2] In addition to the State's contribution for employee health insurance that it provides as a fringe benefit, employees also contribute through payroll deductions from their salaries. Okla. Stat. tit. 74, § 1311 (1995).

3. After learning of the transfer of $31.5 million to the Clearing Fund rather than to the Reserve Fund, DCA issued a Notice of Disallowance to petitioner in October 1997. The Notice explained that the transfer of the federal share of the $31.5 million violated the cost principles of Circular No. A-87—specifically, the requirement that a cost be "allocable to a particular cost objective." 60 Fed. Reg. at 26,492. Because costs charged to federally funded programs for the specific purpose of providing health benefits for state employees working on those federal programs were diverted to other purposes, the federal programs received no benefit from the expenditure of those funds. DCA initially calculated the federal share of the transferred funds to be approximately $10.4 million.

In its response to the Notice of Disallowance, petitioner acknowledged that the transfer was "problematic" and that "some reimbursement is due the Federal Government." Pet. C.A. App. 328. Petitioner, however, disagreed with the amount of the disallowance and contended that approximately $1.16 million was a more appropriate figure. After considering petitioner's arguments and relying on petitioner's own financial data, DCA recalculated the disallowance and determined that the federal share of the $31.5 million transferred from OSEEGIB funds to other State purposes was approximately 23.58%, or $7,426,672. With imputed interest income, the total disallowance was $7,715,064.

4. Petitioner appealed the disallowance to the Departmental Appeals Board (Board), which upheld the $7,426,672 disallowance. Pet. App. 18. The Board explained that the federal government provided federal funds to petitioner to pay a portion of the State's contributions for health insurance for state employees

who work on federally funded programs. Ordinarily, petitioner would have deposited those federal funds directly into the OSEEGIB Reserve Fund, "where they would have generated income and been used to pay health insurance claims and other related expenses." *Id.* at 21-22. But, the Board explained, when petitioner used the federal portion of the $31.5 million for State higher education purposes instead of depositing it into the State's group insurance system, it violated basic federal cost principles. The federal funds at issue were not awarded for higher education purposes and, thus, were not allocable to the particular federal purposes for which they had been awarded. Accordingly, they were not allowable costs under Circular No. A-87. *Id.* at 22. The Board also concluded that petitioner's use of the federal money for State education purposes violated federal appropriations law, 31 U.S.C. 1301(a), as well as the particular federal statutes authorizing reimbursement of the costs of administering various grant and benefit programs. Pet. App. 22-23. "From the point in time that these funds were removed from the reserves, the funds no longer benefited the original contributing programs and no longer fulfilled the terms of the original authorizing legislation." *Id.* at 25.

The Board rejected petitioner's argument that the federal government got what it paid for because State employees received health insurance benefits, notwithstanding the $31.5 million transfer. That argument, it explained, is contrary to "the essential nature of self-insurance funds": because a self-insurance system absorbs losses internally, a fund balance—"maintained in the form of a reserve fund, which generates investment income and protects the self-insurance plan against unforeseen funding shortfalls"—must be carried over from year to year. Pet. App. 23-24. Accord-

ingly, the Board reasoned, the federal government thus expected that the funds that petitioner placed in the Clearing Fund and used for higher education would be deposited in the OSEEGIB Reserve Fund and used for the payment of claims, administrative costs, and investment purposes, as State law requires. Group Insurance Act, Okla. Stat. tit. 74, § 1312(1) (1995). Quoting from petitioner's brief, the Board found that, "[d]ue in part to these transfers, OSEEGIB is presently in somewhat of a funding crisis, in that reserves are less than what is expected to be needed to cover future claims and premiums are rising dramatically." Pet. App. 24.

The Board also rejected petitioner's objection to how the federal share of the transfer to the Clearing Fund was calculated. Pet. App. 27-28. The Board agreed with petitioner, however, that it was not obligated for imputed interest income on the transferred federal funds. *Id.* at 30-32. The Board thus upheld a disallowance of $7,426,672. *Id.* at 32.

5. Petitioner filed suit in federal district court, challenging the Board's decision as contrary to "the laws and regulations governing federal grant programs" and as arbitrary and capricious. Resp. C.A. Supp. App. 10-11 (Am. Compl.). In the alternative, petitioner sought a remand for a recalculation of the amount of the disallowance. *Id.* at 13.

The district court affirmed the Board's decision, App., *infra*, 1a-7a, holding that the decision is not arbitrary or capricious, and that "it is in accord with federal cost allocation principles and is based on substantial evidence," *id.* at 7a.[3]

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[3] In an earlier ruling, the district court dismissed Oklahoma's claim for damages based on unjust enrichment and *quantum meruit* theories. Pet. App. 11-16.

6. The court of appeals affirmed the district court's decision "in all respects." Pet. App. 8.[4] The court also noted that "cost," as defined in Circular No. A-87, explicitly excludes "transfers to a general or similar fund." *Ibid.* (quoting 60 Fed. Reg. at 26,491). Thus, the funds diverted from the OSEEGIB Reserve Fund to the Clearing Fund "fail[ed] to qualify as a reimbursable cost in the first instance." *Ibid.*[5]

ARGUMENT

The judgment of the court of appeals is correct, and it does not conflict with any decision of this Court or any other court of appeals. The questions presented thus do not warrant this Court's plenary review.

1. Petitioner argues (Pet. 9-10) that Circular No. A-87, as applied in this case, impermissibly and unconstitutionally interferes with the State's sovereign affairs. Because petitioner did not raise any constitutional claim below, however, the court of appeals did not address petitioner's contention. This Court should accordingly decline to do so in the first instance. *Glover* v. *United States*, 531 U.S. 198, 205 (2001) (the Court does not ordinarily decide "questions neither raised nor resolved below").[6]

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[4] Oklahoma erroneously states that the amount of the disallowance upheld by the Board, the district court, and the court of appeals is $7,138,280. Pet. 8. The correct amount is $7,426,672. See Pet. App. 3, 32; App., *infra*, 3a.

[5] The court of appeals observed that, although the district court did not base its decision on the definition of "cost" in Circular No. A-87, it was free to affirm that decision on any ground supported by the record. Pet. App. 8.

[6] Petitioner's petition for rehearing in the court of appeals cited, for the first time, several of the decisions cited in its petition before this Court. That petition, however, did not assert any

In any event, petitioner's claim lacks merit. Petitioner's claim is premised on its contention that the funds intended for deposit in the OSEEGIB Reserve Fund and diverted instead to the Clearing Fund constitute money of State *employees* that has "passed through the pockets of the employees who received the fringe benefits from the State as compensation." Pet. 11. That is not correct. Although State employees choose their health insurance provider, payment of that fringe benefit does not pass through their pockets. When the federal government reimburses the State for the latter's cost of the health benefits of those employees who select the OSEEGIB health plan, the federal funds are paid to the employing State agencies (not to the employees), which then deposit that money directly into the Reserve Fund, Okla. Stat. tit. 74, § 1312(1) (1995), or, as occurred in this case, the Clearing Fund, *id.* § 1310.B (Supp. 2002).

Petitioner likewise is incorrect in suggesting that "employee paid premiums" are at issue here. Pet. i, 5. Only "employer contributions" for employee fringe benefits are allowable costs that may be reimbursed. 60 Fed. Reg. at 26,494. Hence, the federal funds in question reimbursed *petitioner* for the portion of the premiums paid by *petitioner*, not the portion of the premiums paid by the employees through payroll deduction (see Okla. Stat. tit. 74, § 1311 (1995)). Indeed, *employee* contributions to health insurance are not reimbursable at all.

Petitioner further overlooks the essential nature and purpose of a state self-insurance fund, in which losses are absorbed internally. As the Board explained, sound

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constitutional claim, and the court of appeals unanimously denied rehearing, without comment. Pet. App. 9-10.

operation of a self-insurance fund requires that "a fund balance be carried over from year to year" and be "maintained in the form of a reserve fund, which generates investment income and protects the self-insurance plan against unforeseen funding shortfalls," such as underestimation of future health care claims. Pet. App. 24. Indeed, that is precisely what the *State's* Group Insurance Act requires: "all * * * contributions" to the State's self-insurance plan "shall be deposited" in the Reserve Fund and shall be used for payment of "all expenses" and for investment purposes. Okla. Stat. tit. 74, § 1312(1) (1995).

Thus, petitioner's obligation to use federal funds intended to compensate the State for its employees' health benefits was not satisfied merely by using the federal funds to pay insurance premiums.[7] When the federal government reimbursed petitioner for its contribution for the cost of those employee benefits, the federal government expected that such funds would be *deposited and maintained* in the Reserve Fund. The money here at issue, however, was not even deposited, let alone maintained, in the Reserve Fund. Instead, it was transferred directly from the State agency recipients to the newly-created Clearing Fund and used for

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[7] As support for its contention that its obligation to the federal government was fulfilled once the insurance premiums were paid, Oklahoma cites *NYS Health Maintenance Organization Conference* v. *Curiale*, 64 F.3d 794 (2d Cir. 1995). That case, however, had nothing to do with a State self-insurance plan, OMB Circular No. A- 87, or a State's use of federal money intended as reimbursement of the State's costs in administering federal programs. At issue, *inter alia*, was whether a benefits plan administrator had fulfilled his statutory fiduciary duty under the Employee Retirement Income Security Act. *Id.* at 799 n.13.

State education purposes, not the use intended and authorized by the federal government.[8]

This Court has long recognized that the United States has the "power to fix the terms upon which its money allotments to states shall be disbursed." *Oklahoma* v. *Civil Serv. Comm'n*, 330 U.S. 127, 143 (1947). An early opinion of the Comptroller General also makes clear that moneys paid by the federal government to the States in connection with various aid programs "are held in trust by the States for the purposes of the [pertinent federal statutes] until they have been expended for those purposes." 1 Comp. Gen. 652, 655 (1922). Moreover, the States are not entitled to profit from such funds, and any interest that accrues "while the moneys are so held by the States inures to the benefit of the United States as owner of the funds and not to the States as trustees." *Ibid.* See, *e.g.*, *Pennsylvania Office of the Budget* v. *Department of Health & Human Servs.*, 996 F.2d 1505 (3d Cir.) (federal government was entitled to its share of interest earned on self-insurance reserve partly funded with federal money), cert. denied, 510 U.S. 1010 (1993).

Consistent with those principles, OMB Circular No. A-87 establishes the requirements that States must satisfy when seeking reimbursement from the federal government for their costs in administering federal programs. Contributions to State self-insurance plans are allowable and reimbursable, but only so long as

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[8] Indeed, when it established the Clearing Fund, the Oklahoma legislature recognized that it would be funded not only with State appropriated money, but also with "other funds available to such agency for operational purposes," Okla. Stat. tit. 74, § 1310.B (Supp. 2002), which would include federal cost reimbursement money intended for non-educational purposes.

certain conditions are met. 60 Fed. Reg. at 26,498-26,499, 26,502. Because State self-insurance plans are not commercial, for-profit enterprises, the maintenance of an appropriate reserve level is of particular concern to the federal government. The reserve must be adequate to pay claims and administrative expenses, but not excessive. Circular No. A-87 therefore requires reserve levels to be "analyzed and updated at least biennially for each major risk being insured" and to "take into account any reinsurance, coinsurance, etc." *Id.* at 26,499. Excessive reserve levels must be explained and justified. *Id.* at 26,499, 26,502. If funds are transferred from a self-insurance reserve to a State's general fund, the federal government's share of the transferred funds must be refunded to the United States, with interest accruing from the date of the transfer. *Id.* at 26,499.

Based on those requirements, the federal government expected that the funds it paid to petitioner for the health benefits of State employees who worked on federal programs would be deposited and maintained in the OSEEGIB Reserve Fund, so as to ensure adequate funding for future claims. That money retained its federal character, and petitioner's transfer of such funds to nonfederal purposes violated federal appropriations law and Circular No. A-87.

2. The decision of the court of appeals does not conflict with this Court's decision in *Zelman* v. *Simmons-Harris*, 122 S. Ct. 2460 (2002), and other Establishment Clause jurisprudence. Contrary to petitioner's contention, *Zelman* did not involve "the same issue" that is before the Court here. Pet. 17. In that case, the Court ruled that a school voucher program, designed to provide educational choices to families within the Cleveland City School District, did

not violate the First Amendment's prohibition of laws that have the purpose or effect of advancing or inhibiting religion. 122 S. Ct. at 2463; see *id.* at 2465. Under that program, tuition aid is paid directly to parents (on the basis of financial need), and the parents then endorse the checks over to the public or private school in which they have chosen to enroll their child. *Id.* at 2464.

Apart from the facts that the Establishment Clause is in no way implicated in the instant case, and that federal reimbursement of State costs under Circular No. A-87 was not involved in *Zelman*, there are other critical differences between the two cases. Unlike *Zelman*, no "government funds [are] paid to private individuals" in this case. Pet. 17. As explained above, the federal government reimburses the State agencies for the costs they incur in administering federal programs, including State employee health benefits. The State employees who work on such programs are entitled to choose their health insurance plan, but they do not receive any federal funds. Moreover, unlike the State agencies that do receive such funds, State employees are not "responsible for the efficient and effective administration of Federal awards through the application of sound management practices." 60 Fed. Reg. at 26,490.

3. Petitioner also mistakenly argues that the federal funds here at issue lost their federal character under the "supervision and control" test applied by some circuits. Under that test, the courts examine "the basic philosophy of ownership reflected in the relevant statutes and regulations," and "the supervision and control contemplated and manifested on the part of the [federal] government." *United States* v. *Long*, 996 F.2d 731, 732 (5th Cir. 1993) (quoting *United States* v.

Evans, 572 F.2d 455, 472 (5th Cir.), cert. denied, 439 U.S. 870 (1978)). "[W]hen an outright grant is paid over to the end recipient, utilized, commingled or otherwise loses its identity, the money in the grant ceases to be federal." *United States* v. *Hope*, 901 F.2d 1013, 1019 (11th Cir. 1990) (quoting *United States* v. *Smith*, 596 F.2d 662, 664 (5th Cir. 1979)), cert. denied, 498 U.S. 1041 (1991).

The federal funds involved in this case amply satisfy the supervision and control test. Circular No. A-87's numerous references to and requirements concerning State self-insurance funds and their reserves demonstrate the federal government's supervision, control, and significant continuing interest in how federal money deposited in such funds is managed and used. Further, that money is not paid to the State as "an outright grant," but rather comes with strings attached, as set forth in the Circular. Thus, petitioner's suggestion that this case is about "private choice" in the use of funds provided by the federal government, but over which the government has no continuing supervision, Pet. 19, is without basis.[9]

4. Petitioner also errs in suggesting for the first time in this Court that the conditions imposed on the federal funds it received were not "unambiguously expressed" in its "contract" with the federal government—*i.e.*, "the four corners of OMB [Circular No.]

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[9] It bears noting that Circular No. A-87 and the disallowance determination here have no impact whatsoever on the employee's choice of health insurance. Petitioner remains free to offer a flexible benefit allowance, which permits its employees to choose health and other insurance from either the OSEEGIB or a private insurer. Petitioner is restricted only in what *it* may do with federal funds used to purchase benefits from the State-operated insurance plan.

A-87." Pet. 21, 22.[10] Circular No. A-87 sets forth in detail a State's obligations respecting its use of federal funds obtained as reimbursement for the costs of insurance provided by the State's own self-insurance fund and, in particular, the management of a self-insurance reserve. Pp. 3-4, *supra*. Petitioner's claim that it did not have adequate notice of such obligations is therefore wholly lacking in merit.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 2003

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[10] In this connection, Oklahoma argues that the court of appeals' decision conflicts with *Barnes* v. *Gorman*, 122 S. Ct. 2097 (2002), which held that punitive damages are not available in private suits brought under the Americans with Disabilities Act and the Rehabilitation Act. *Id.* at 2103. In analogizing that Spending Clause legislation with a contract for federal funds, the Court noted the well established principle that, "if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously." *Id.* at 2101 (quoting *Pennhurst State Sch. & Hosp.* v. *Halderman*, 451 U.S. 1, 17 (1981)). Apart from that quotation, however, *Barnes* has no relevance to this case.

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

No. CIV-00-316-W

STATE OF OKLAHOMA EX REL. OFFICE OF STATE FINANCE, PLAINTIFF

v.

TOMMY G. THOMPSON, SECRETARY OF HEALTH AND HUMAN SERVICES EX REL. DEPARTMENT OF HEALTH AND HUMAN SERVICES, AND UNITED STATES OF AMERICA, DEFENDANTS

[Filed: July 18, 2001]

ORDER

The plaintiff, State of Oklahoma ex rel. Office of State Finance ("State"), brought this action seeking judicial review under the Administrative Procedures Act ("APA"), 5 U.S.C. § 706(2), of a decision issued by the Departmental Appeals Board ("DAB") of the United States Department of Health and Human Services. The State and the defendants, Tommy G. Thompson, Secretary of Health and Human Services ex rel. United States Department of Health and Human Services ("HHS"), and the United States of America, have submitted argument and authority in support of their respective positions. Based upon these submissions, the Court makes its determination. In so doing, the Court has not set forth a detailed recitation of the

events giving rise to the instant controversy since the essential facts are undisputed and are sufficiently set forth in the parties' papers.

State employees may elect to receive health, disability, life and other benefits through the Oklahoma State and Education Employees Group Insurance Board ("OSEEGIB"), a self-insurance program that is governed by the State and Education Employees Group Insurance Act ("SEEGIA"), 74 O.S. §§ 1301-1327. Many state employees work on federally-funded programs, and the federal government has annually paid funds to the state agencies administering federal grants or federal-state programs to reimburse them for a portion of their employer contributions to the OSEEGIB. The federal and state funds that constitute the agencies' share of premiums are deposited into the State Employees Group Insurance Clearing Fund ("Clearing Fund"). These funds are in turn deposited in the appropriate OSEEGIB reserve account and used to pay employees' claims or administrative expenses, or used to generate income.

In 1996, the Oklahoma legislature amended the SEEGIA so that in fiscal year 1997, the first $31.5 million deposited into the Clearing Fund was distributed to the Oklahoma State Regents for Higher Education to pay the expenses of the State's higher education system. 74 O.S. § 1312.3(1). The remainder was then distributed to and deposited in the appropriate OSEEGIB reserve account. *Id.* § 1312.3(2).

Acting on its belief that federal funds paid to state agencies on behalf of employees working on federally-funded programs were being used for an unauthorized purpose, HHS's Division of Cost Allocation sought repayment of the allegedly diverted funds. On October

8, 1997, HHS formally notified the State of HHS's determination that the State had violated the cost allocation provisions of United States Office of Management and Budget ("OMB") Circular A-87, as revised. By letter dated January 29, 1998, HHS disallowed $7,426,672.00[1] of federal funds paid to the State, plus interest.

On February 27, 1998, the State appealed to the DAB.[2] On August 18, 1998, the DAB issued Decision No. 1668, sustaining the disallowance of those federal funds received by the State for a portion of the costs of group health insurance premiums paid on behalf of state employees and diverted to higher education programs, but reversing the disallowance of the amount claimed as interest.

The DAB found:

> "The federal government awarded the disallowed funds to pay a portion of Oklahoma's employer contributions for health insurance for its state employees, to the extent that those employees work on

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[1] The original disallowance totaled $20,412,088.00. That amount was eventually reduced to $7,715,064.00, which HHS contended represented the federal share of the $31.5 million transfer ($7,426,672.00) and earned or imputed interest ($288,392.00).

[2] In its appellate brief, the State characterized the matter as follows:

> "The disallowed costs arise from the State's use of $31.5 million collected by the . . . OSEEGIB . . . during the fiscal year ended June 30, 1997. The State used this money to fund needed expenditures in the State's system of higher education. The amount transferred from OSEEGIB consisted of the first $31.5 million of employer contributions for group health insurance premiums for state employees received by OSEEGIB in the fiscal year."

> federally funded programs. Oklahoma would ordinarily have deposited the premiums into the OSEEGIB reserves, where they would have generated income and been used to pay health insurance claims and other related expenses. . . . Instead, Oklahoma removed the funds from its group insurance system and used them to pay the costs of higher education.
>
> "The higher education expenditures were not necessary and reasonable for the provision of health insurance for state employees working on federal programs, the purpose for which the funds were awarded. The high education costs did not benefit and consequently were not allocable to those federal awards. The education costs were thus not allowable charges to federal awards under OMB A-87.
>
> "By using the federal funds for higher education expenses, Oklahoma also violated the basic principle of appropriations law that federal funds must be used for the purposes for which they are awarded. Additionally, the various federal program statutes and regulations (and appropriation statutes) that authorize the use of federal funding for payment of administrative costs require that the funding be used only for the authorized programmatic purpose. . . ."

DAB Decision No. 1668 (August 18, 1998) at 4 (citation and footnote omitted).

This Court's review of the DAB's decision is governed by the APA,[3] and the Court must uphold this

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[3] Because this Court's review is limited to the administrative record, *see* Order at 2-3 n.3 (August 31, 2000), the Court has not

decision unless it finds that the decision is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," 5 U.S.C. § 706(2)(A), or that it is "unsupported by substantial evidence. . . ." *Id.* § 706(2)(E). "To make this finding the [C]ourt must consider whether the decision [is] . . . based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971) (citations omitted). The "standard of review is a narrow one," *id.*, and "[t]he [C]ourt is not empowered to substitute its judgment for that of the agency." *Id.* Rather, the Court must determine whether "the agency . . . examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found the choice made.'" *Motor Vehicle Manufacturers Association of the United States, Inc.* v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168 (1962)).

If the decision involves the interpretation of an agency's own regulations, that interpretation must be given "substantial deference," *Thomas Jefferson University* v. *Shalala*, 512 U.S. 504, 512 (1994) (citations omitted), and ""controlling weight unless it is plainly erroneous or inconsistent with the regulation,"" *Id.* (quoting *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965) (quoting *Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945))).

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considered the Affidavits of Tam Daxon (February 12, 2001, and June 19, 2001) or the Declaration of Terry D. Hill (April 26, 2001).

The principle that federal "[a]ppropriations shall be applied only to the objects for which the appropriations were made . . .," 31 U.S.C. § 1301(a), is embodied in OMB Circular A-87, which was issued as a guideline to government agencies for determining allowable costs incurred by the State under grants, cost reimbursement contracts and other agreements with the federal government. To be allowable, costs must, inter alia, "[b]e necessary and reasonable for proper and efficient performance and administration of [the grants, cost reimbursement contracts, and other agreements with the federal government], OMB A-87, Attachment A ¶ C.1.a, and they must "[b]e allocable," *id.* Attachment A ¶ C.1.b, to the same. "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received." *Id.* ¶ C.3.a.

The Court has carefully considered the State's challenges to the DAB's decision and in particular has examined the State's arguments (1) that the DAB relied upon a DAB decision, *Texas Office of the Governor*, DAB No. 1608 (1997), that was ultimately vacated, *Texas* v. *United States Department of Health and Human Services*, No. A 99-CA-056 SS (W.D. Tex. Aug. 28, 2000); (2) that the DAB relied on facts not present in the record; (3) that the DAB failed to fully develop the record and failed to obtain allegedly critical testimony;[4] (4) that the DAB applied an incorrect legal standard and made errors of law; and (5) that the DAB engaged in speculation in arriving at its decision.

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[4] There is no evidence in the record that the State was denied the opportunity to present any evidence or arguments it deemed critical to the issues before the DAB.

Under the standards which govern its review, the Court finds the challenged decision is neither arbitrary or capricious, nor an abuse of discretion; it is in accord with federal cost allocation principles and is based on substantial evidence. *E.g.*, *Dickinson* v. *Zurko*, 527 U.S. 150, 162 (1999) ("substantial evidence" standard requires court to ask whether "reasonable mind might accept" particular evidentiary record as "adequate to support a conclusion"). The DAB applied the correct legal standards, and the Court finds no argument advanced by the State warrants the relief the State has requested.

Accordingly, the Court

(1) AFFIRMS in all respects DAB Decision No. 1668 issued on August 18, 1998; and

(2) ORDERS that judgment issue in favor of HHS and the United States forthwith.

ENTERED this 18th day of July, 2001.

/s/ LEE R. WEST
LEE R. WEST
United States District Judge